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IN THE

Supreme Court of the United States

OCTOBER TERM, 1931.

No. 26.

UNITED STATES, *Plaintiff in Error,*

vs.

KIRBY LUMBER CO., *Defendant in Error.*

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE AND BRIEF IN SUPPORT OF THE DECISION OF THE COURT OF CLAIMS.

J. MARVIN HAYNES,
Counsel for the
American Tobacco Company.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE.

May It Please the Court:

The undersigned as Counsel for The American Tobacco Company respectfully moves this Honorable Court for leave to file the accompanying brief in this case as Amicus Curiae.

J. MARVIN HAYNES,
Counsel for the American Tobacco Company.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1931.

No. 26.

UNITED STATES, *Plaintiff in Error,*

vs.

KIRBY LUMBER CO., *Defendant in Error.*

BRIEF OF THE AMERICAN TOBACCO COMPANY, AS AMICUS CURIAE, IN SUPPORT OF THE DECISION OF THE COURT OF CLAIMS.

PRELIMINARY STATEMENT.

The American Tobacco Company is a New Jersey Corporation. At various times during the years 1924, 1925 and 1927 the American Tobacco Company purchased some of its bonds, issued for cash at par, in the open market for cash at a price less than par. The Commissioner of Internal Revenue in his final

determinations of the American Tobacco Company's tax liability for the years 1924, 1925 and 1927 increased the Company's net income by the difference between the prices at which the bonds were issued by the Company and the price paid therefor by the Company upon their retirement. The Company appealed from this determination by the Commissioner of Internal Revenue to the Board of Tax Appeals, which sustained the Company's contention and found that the inclusion of the difference between the price at which the Company purchased its bonds and the price at which it issued them in the Company's income for the respective years was erroneous. The Commissioner has filed a petition for review to the United States Circuit Court of Appeals for the Second Circuit.

ARGUMENT.

I. No Income is Realized From the Purchase and Retirement of Bonds for an Amount Less than the Issuing Price.

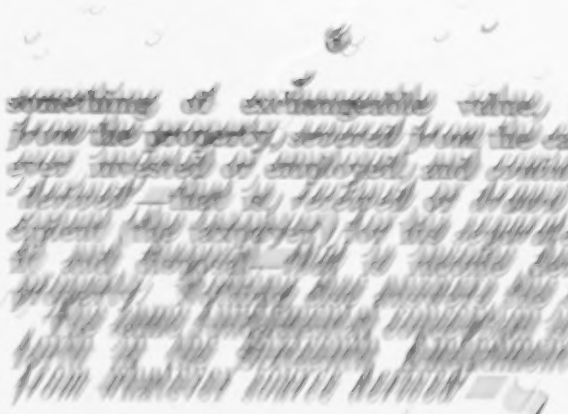
Most of the argument in this cause has been directed to the proposition that this case is controlled by the decision of this Court in *Bowers v. Kerbaugh-Empire Co.*, 271 U. S. 170. We believe that this proposition is sound, and that the case can be shortly disposed of on that basis. But even if the *Kerbaugh-Empire* decision should be restricted to its peculiar facts, we submit that, under prior decisions of this Court, the decision of the Court of Claims should be affirmed. Since the application of the *Kerbaugh-Empire* decision to the facts herein has been ably developed by other counsel, this brief will be mainly di-

rected to the proposition that the prior decisions of the Court, of which the *Kerbaugh-Empire* decision was a particular application, establish that no income is realized from the purchase and retirement of bonds for an amount less than the issuing price.

The federal courts were early confronted with the question whether all *gains* are *income* within the meaning of the Sixteenth Amendment. If economists' definitions had been followed, the two terms would have been held to be synonymous. One of the best-known definitions of an economist declares income to be "the money value of the net accretion to one's economic power between two points of time". (Robert Murray Haig in The Federal Income Tax, Columbia University Lectures, p. 7)

In *Eisner v. Macomber*, 252 U. S. 189, the Court not only refused to accept the economist's conception of income, but laid down affirmatively an authoritative definition, and stated the tests by which it might be determined whether a particular gain was or was not income. After stating the well-known definition of income, the Court said:

> Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy. The government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word 'gain,' which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. *'Derived—from—capital'*; 'The *gain—derived—from—capital'*, etc. Here we have the essential matter; *not* a gain *accruing* to capital; not a *growth* or *increment* of value *in* the investment; but a gain, a profit,



The emphasis here is upon the severance of the item under consideration. An increase in capital does not constitute income, as it would under an economist's definition. It must be separated or derived from capital, not a gain accruing to capital.

Again, in a preceding passage, the court stated another test for the determination of the meaning of the term income as used in the amendment:

> For the present purpose we require only a clear definition of the term income as used in common speech, in order to determine its meaning in the amendment. * * *

In other words, the term "income" as used in the Sixteenth Amendment bears that meaning which the people who adopted it would give the term; so the meaning which economists or other specialists may ascribe to it for their particular purposes

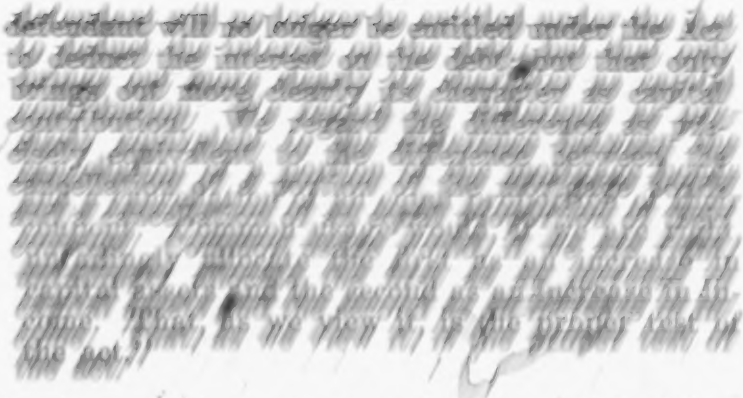
In the previous year, the federal circuit court of appeals in the Second Circuit had had to deal with a case quite similar to that herein. In *U. S. v. Oregon Washington R. R. & Nav. Co.*, 251 Fed. 211, a creditor of the defendant, which was also defendant's sole stockholder, released in its favor an indebtedness of

true [illegible]. The Government proceeded on the theory that the defendant had profited to the extent of $[illegible], as indeed it had, and that the fact was decisive. The court, per Lamar, J., held that this was not the meaning, saying:

> "However, the law, though it includes income from all sources, does not define income. Nor is the meaning of the word to be found in its lexicographical derivation. Its meaning is rather to be gathered from the implied assumptions of its use in common speech. The implied distinction, it seems to us, is between permanent sources of wealth and more or less periodic earnings. Of course, the term is not limited to earnings from economic capital; i. e., wealth industrially employed in permanent form. It includes the earnings from a calling, as well as interest, royalties, or dividends, though in the case of corporations this may be of slight importance. Yet the word unquestionably imports, at least so it seems to us, the current distinction between what is commonly treated as the increase or increment from the exercise of some economically productive power of one sort or another, and the power itself, and it should not include such wealth as is honestly accumulated to meet [illegible] and customarily be treated as the capital of the corporation [illegible]."

In the Oregon-Washington case, the creditor was the sole stockholder of the debtor, a fact which does not obtain in the instant case. But the court evidently rested its decision upon broader grounds, applicable herein, for it said:

> "The financial relief so given, will, it is true, be eventually reflected in the income, since the



In other words, a decrease in the capital obligations of a company, with a corresponding increase in its net worth, does not result in income to it. A cancellation of bonds does not give rise to income; by the same token, the retirement of bonds for less than the issuing price does not result in income. Both are essentially capital transactions, and do not fall within the term income as used in common speech.

This court again distinguished "gain" from "income" in *Edwards v. Cuba R. Co.*, 268 U. S. 628, decided a year previously to the *Kerbaugh-Empire* case. In that case, the Government of Cuba had granted certain subsidies of money and property to the Railroad. In consideration of such grants, the railroad agreed to construct certain lines, and to reduce its passenger and freight rates in certain specified instances. The collector, Edwards, urged that the subsidies were income to the Railroad, pointing both to the large gain in the Company's assets, and to the fact that the subsidies could be regarded as advance payments to the company in respect of the services for which reduced rates were to be given.

The court rejected these arguments, and held that the subsidies were not taxable income, for these reasons:

"The subsidy payments were appropriations to encourage the building of railroads, and were not profits or gains from the use or operation of the railroads. The subsidies were paid for the same purposes, it cannot reasonably be held that one was contribution to capital assets, and that the other was profit, gain or income. Neither the laws nor the contracts indicate that the money subsidies were to be used for the payment of dividends, interest, or anything else properly chargeable to or payable out of earnings or income. The subsidy payments taxed were not made for services rendered or to be rendered. They were not profits or gains from the use or operation of the railroad, and do not constitute income within the meaning of the Sixteenth Amendment. See *Stratton's Independence v. Howbert*, 231 U. S. 399, 415; *Eisner v. Macomber*, 252 U. S. 189, 207; *Merchants' Loan & Trust Co. v. Smietanka*, *supra* (255 U. S. 509)."

In this case, as in the *Oregon-Washington* case, the net worth of the company was greatly increased by the subsidies. The opinion states that in 1919 the payments "were transferred to the surplus account, and were used for capital expenditures." The company undoubtedly realized a "gain" during the years in question, since its assets increased with no corresponding increase in the liabilities. Yet it realized no taxable income, for the reason that the gain was a gain in capital assets, as in the *Oregon-Washington* case, and in the *Kerbaugh-Empire* case; a "growth in the investment," to use the terms of *Eisner v. Ma-*

comber, not "something of exchangeable value *proceeding from* the property, *severed from* the capital."

The same distinction was applied in the *Kerbaugh-Empire* case. The taxpayer therein had paid $80,000 in discharge of its note, for which some years previously it had received $724,000. The court held that no income to the taxpayer had resulted from the transaction, applying the definition and distinction of *Eisner v. Macomber*; that the transaction did not result in gain from capital and labor, or from either of them, or in profit gained through the sale or conversion of capital. The decision accords with the analysis of *Eisner v. Macomber* and *Edwards v. Cuba R. Co.*; that, while the taxpayer realized a gain from the transaction, it was not such a gain as is commonly regarded as taxable income.

The principal case, as the Court of Claims and the Board of Tax Appeals have held in this and many like situations, is controlled by these decisions. As in the *Kerbaugh-Empire* case, the taxpayer herein received for its bonds an amount in excess of that which it had to pay to discharge them. Its balance sheet would thereby show a gain; its liabilities were reduced by $1,000,000, whereas its assets were reduced only $940,000. But this reduction of liabilities was not "severed from its capital" and "coming in"; it was rather a gain "accruing to capital", of the same sort as the cancellation of indebtedness in the *Oregon-Washington* case, the subsidies in the *Cuba R. Co.* case, and the retirement of the note in the *Kerbaugh-Empire* case—none of which were income.

This conclusion may be reinforced on the facts in another way. In the principal case, the bonds were retired in the same year in which they were issued.

Unless the financial situation of the obligor largely changed, therefore, which was not shown, it would appear that the obligor's ability to retire the bonds at less than the issuing price was due to an increase in the value of the dollar during the year. It is a commonplace that the federal income tax does not take account of fluctuations in the value of our own currency. For the same reason the taxpayer should not be compelled to pay an income tax on an essentially fictitious gain resulting from such a fluctuation in currency values. The term "income" as used in common speech clearly does not comprehend a gain of this character.

CONCLUSION.

For these reasons, it is respectfully submitted that the Court of Claims did not err in holding that the decision in *Bowers v. Kerbaugh-Empire Co.*, is controlling herein; and that no income is realized from the purchase and retirement of bonds for an amount less than the issuing price.

Respectfully submitted,

J. MARVIN HAYNES,
Counsel for the
American Tobacco Company.